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Thoughts from the Chairman

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About the Freeman Chair

CHRISTOPHER JOHNSON
Freeman Chair
in China Studies

BONNIE S. GLASER
Senior Adviser for Asia

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MUTUAL DISTRUST CREEPING INTO U.S.-CHINA ECONOMIC TIES

CHRISTOPHER JOHNSON

As 2012 draws to a close, it's a good time to take stock and review the macro trends in U.S.-China ties over the course of a very challenging year for the bilateral relationship. The rare convergence of a U.S. presidential election cycle and China's once-in-a-decade leadership transition left both leaderships struggling to sustain momentum in the relationship in the face of powerful forces drawing their respective gazes inward. One consequence of the ensuing drift in the bilateral relationship was the emergence of growing concerns about "strategic distrust" between Beijing and Washington, or the deepening suspicion of each country's long-term intentions toward the other.

The problem of strategic distrust is a valid concern, but much of the worry seems overstated. There are a number of reasons to believe this to be the case, but, in simplest terms, the anxiety over this issue is fundamentally tied to perceptions in both capitals that are highly susceptible to change, and thus may be far less enduring than one might assume at first glance. In fact, there is every reason to believe that these perceptions could reverse themselves in the next few years in a way that reduces strategic distrust.

A key driver of strategic distrust, for example, is the perception in Beijing that China since the global financial crisis has ascended to the ranks of the world's leading powers, while the United States has stumbled (or worse, in the assessment of some in China, embarked on a steady downward spiral of decline). Similarly, Washington is unsure of itself as it struggles to restore the international reputation for economic competency and leadership that has for so long undergirded American power abroad. These shifts, so the thinking goes,

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promote strategic distrust because Beijing is certain that the United States is determined to protect its leading position at the expense of China's rise, and an insecure Washington is equally concerned that China has embarked upon a zero-sum campaign to undermine U.S. interests in Asia as manifested by Beijing's increasingly hegemonic approach to its regional neighbors.

But the core strengths of the United States—a world-class education system and an entrepreneurial spirit that combine to drive the type of innovation fundamental to success in the knowledge-based economy of the 21st century—remain unchanged, and the prospect of much greater energy independence offers the impetus for America's resurgence. The mere fact that the declinist voices in Beijing are much quieter than in the immediate aftermath of the financial crisis speaks to the power of the trend. Likewise, the Chinese system is showing the limitations of the current economic growth model that has propelled its steady rise. The types of reforms needed to unlock another massive wave of Chinese economic expansion present the incoming leadership team with a challenge that is both difficult and multilayered.

As such, it is not beyond reason to conclude that the next 3-5 years could witness another resetting of the bilateral power equation by which a more confident United States is less concerned with perceived manifestations of Chinese assertiveness and a very inward-focused Chinese leadership is more measured in its approach to the region and in its relations with Washington. The resulting equilibrium may offer the best prospects for establishing the "new type of great power relationship" Vice President Xi Jinping spoke of during his visit to Washington earlier this year.

Still, getting to this new "sweet spot" in bilateral ties is far from a foregone conclusion. An emerging stumbling block is the rise of much sharper mutual distrust in the bilateral economic relationship. Secretary of State Hillary Clinton noted last month that "there is reason to hope that over the coming years, we can in fact chart a path that avoids conflict and builds on the areas where our interests align," while Xi during his U.S. visit stated on several occasions that U.S.-China economic and trade ties should serve as the "ballast" for and "propeller" of the overall bilateral relationship. It is the strong economic interdependence between our two nations that offers the best hope for finding, again in the words of Secretary Clinton, "a new answer to the old question of what happens when an established power and a rising power meet."

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Instead, however, the economic relationship appears to be emerging as a new source of mutual suspicion and distrust. For example, a regulatory dispute over auditing procedures for Chinese companies listed in the United States escalated this month, when the U.S. Securities and Exchange Commission (S.E.C.) charged the Chinese affiliates of five of the world's biggest auditing firms with violations of U.S. securities law for failing to provide access to audit records the Chinese firms said could not be disclosed without violating China's state secrecy laws. The standoff has the potential not only to force the Chinese firms to delist from stock markets in the United States, but also could put American multinationals that do business in China in a position where they have difficulty producing audited accounts. The U.S. Chamber of Commerce underscored the escalatory potential of the standoff in a letter to the S.E.C. and its Chinese counterpart that stated that "The threat of retaliatory actions by regulators, on both sides of the Pacific, may create a regulatory protectionism that will harm both economies."

Frustrated with depressed share prices and perceived excessive scrutiny by regulators, some Chinese firms are already heading for the exits. Just last week, the directors of Focus Media holdings, a display advertising company based in Shanghai, accepted the largest privatization bid yet for a Chinese firm in a deal that would delist the firm from the Nasdaq. Proposed Chinese delistings reportedly accounted for a record 16 percent of such transactions globally during the first nine months of this year, up from six percent a year earlier.

Underscoring Chinese concerns, Wang Qishan—the departing Chinese vice premier for commerce, trade, and finance and a newly-promoted member of the ruling Politburo Standing Committee—complained after the latest round of high-level bilateral trade talks under the U.S.-China Joint Commission on Commerce and Trade (JCCT) that Chinese companies should not have to undergo "political background checks" to invest in the United States, according to media accounts. Outgoing Chinese Commerce Minister Chen Deming struck a similarly cautious tone following the JCCT, saying that fair treatment of Chinese trade and investment was a principal Chinese concern and that China needed to "wait for a while" to observe "what kind of measures the U.S. side is going to take." A new report by the Committee on Foreign Investment in the

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U.S. (CFIUS) purportedly finding that one or more foreign governments had directed companies to acquire critical American technologies in a "coordinated strategy" is sure to add fuel to the fire.

Of course, U.S. firms operating in China are facing an equally if not more frustrating environment. Unfair preferences granted to Chinese state firms, burdensome local content requirements, and a trend toward shorter-term contracts that seem designed solely to assist local joint venture partners in acquiring key technologies are but some of the challenges firms are grappling with. This is to say nothing of the much broader concerns about the rampant theft of intellectual property in cyberspace that is becoming a nascent source of instability in U.S.-China ties.

Fixing these problems won't be easy, but it is an essential task for the new Chinese leadership and for the second Obama administration going into 2013. On the Chinese side, Premier-in-waiting Li Keqiang has been quick to underscore that urbanization will be the main driver of Chinese economic growth for the future, even signaling the Party intends to address some of the many thorny problems—such as land use rights and reforms to the Chinese household registration system—that must be tackled for the policy to succeed. But he has been silent on the equally complex, and no less necessary, issue of corporate governance reform in China, which is where many of the areas of U.S. concern reside. For its part, the United States needs to do a better job of publicizing the fact that the great majority of Chinese investment proposals in the United States—even in strategic sectors like emerging energy technologies—are approved, often without CFIUS review. The United States also must set comprehensive guidelines and a much clearer procedural and regulatory roadmap for Chinese firms eager to invest, or just to do business, in this country to follow. As with the many daunting challenges in the strategic dimension of the relationship, it will take bold leadership from senior officials on both sides to ensure that economic ties remain a source of bilateral stability instead of another source of friction. ■

EVENT PLAYBACK

Schieffer Series: China's Leadership Transition and Looking Ahead at U.S. - China Relations | December 4, 2012

From left to right: Richard McGregor, the Honorable Kurt Campbell, Bob Schieffer, and Christopher K. Johnson

"The region and the world demand that the United States and China make an extraordinary effort to make sure that our relationship is strong, stable, and predictable." —The Honorable Kurt Campbell

This Schieffer Series featured a discussion with the Honorable Kurt Campbell, Assistant Secretary of State for East Asia and the Pacific; Richard McGregor, Washington Bureau Chief of the Financial Times; Freeman Chair Chris Johnson; and Bob Schieffer, Chief Washington Correspondent of CBS News. The discussion focused on China's leadership transition and the future of U.S.-China relations.Watch the video recording of the event, here.

Australia in the Asian Century: Between America and China | December 7, 2012

From left to right: Professor Hugh White, Ernest Bower, and Christopher K. Johnson

"Australia has an extraordinarily significant, longstanding, deep and valued relationship with the United States and we have an extraordinarily significant, more recent, deepening relationship with China."
—Professor Hugh White

CSIS Pacific Partners Initiative hosted Hugh White, Professor of strategic studies at Australian National University and Christopher Johnson, CSIS Senior Advisor and Freeman Chair in China Studies, December 7 for a panel discussion on China's relations with its neighbors, in particular Australia, and evolving Australia-China-United States relations in the new Asian century. The discussion was moderated by Ernest Bower, Senior Advisor and Chair for Southeast Asia Studies at CSIS. Learn more by watching the event coverage.

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